In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 1333

SOUTHERN ARIZONA BANK AND TRUST COMPANY, A CORPORATION, AND PEGGY L. MARTIN, EXECUTORS OF THE ESTATE OF GEORGE MARTIN, DECEASED, AND PEGGY L. MARTIN, PETITIONERS

v.

UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Prior to 1955, George Martin owned all the stock in Crystal Coca-Cola Bottling Company ("Crystal"), an Arizona corporation engaged in the bottling business. In 1955, he agreed to sell the stock to two individuals who organized a new corporation, Coca-Cola Bottling Company of Tucson, Inc. ("Tucson"), to assume the business operation of Crystal. That agreement was later amended to provide that Martin would transfer his Crystal stock to Tucson, rather than the two individuals, in return for Tucson's promissory note for $1,450,000, secured by a pledge of the shares of stock of both corporations. It was understood that

Tucson would thereafter have the right to liquidate Crystal and obtain a release of the pledge of the latter's shares of stock. (Pet. 4a–5a, 12a–13a.)

In the sales agreement, Martin agreed to indemnify the purchasers for any taxes owed by Crystal for periods prior to the closing of the transactions, which occurred November 1, 1965. The buyers could, at their option, collect any tax claim from Martin or deduct such claim from the purchase price due him, provided, however, that Martin would first have the right to contest or litigate any tax claim at his own expense (Pet. 5a, 13a–14a). When Martin transferred his Crystal stock to Tucson, Crystal was immediately liquidated and its assets transferred to Tucson (Pet. 4a–5a, 14a).

The Internal Revenue Service issued a statutory notice of transferee liability to Tucson, asserting deficiencies of $117,057.46 in Crystal's income and excess profits taxes for the taxable years 1951 through 1955. Pursuant to the "indemnity clause" in the sales agreement, Martin contested the tax deficiencies and transferee liability of Tucson in a suit before the Tax Court of the United States. That court found Tucson's transferee liability to be $50,872.16, and the Ninth Circuit affirmed[1] (Pet. 5a, 14a–15a).

Martin incurred expenses of $23,659.42 for legal and accounting services in connection with that litigation for which a deduction was claimed on his and his wife's joint federal income tax return for 1961. The Commissioner disallowed the deduction (Pet. 5a–6a, 15a–16a).

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[1] *Coca-Cola Bottling Co. of Tucson* v. *Commissioner*, 37 T.C. 1006, affirmed, 334 F. 2d 875 (C.A. 9).

The Martins paid the resulting deficiency, claimed a refund, which was denied, and brought this suit[2] in the United States Court of Claims (Pet. 16a). The Court of Claims sustained the Commissioner's disallowance of the claimed deduction (Pet. 9a).

The decision of the Court of Claims is correct and there is no conflict or other reason warranting review by this Court.

1. The only issue which is before this Court on the petition for certiorari is whether the claimed deduction was proper under Section 212(3) of the Internal Revenue Code (Pet. 2). This statute permits an individual to deduct non-trade or non-business expenses which are "ordinary and necessary expenses paid or incurred * * * in connection with the determination, collection, or refund of any tax." By this section, Congress intended to permit the deduction of legal expenses only by a taxpayer whose *own* tax liability was involved in the determination of tax. *United States* v. *Davis*, 370 U.S. 65, 74. Petitioners seemingly do not dispute this principle (Pet. 4-5), but recognize that the deduction was available only if Martin was personally liable for the tax as transferee of Crystal (Pet. 5).

When Martin was sole shareholder of Crystal, the tax liabilities were Crystal's and not his. Cf. *Moline Properties* v. *Commissioner*, 319 U.S. 436. The transfer of Crystal's assets to Tucson did not impose the

[2] During the pendency of this suit before the Court of Claims, George Martin died and petitioners, the executors of his estate, were substituted as parties plaintiff on behalf of his estate (Pet. 12a).

liabilities on Martin. Section 6901(a)(1)(A)(i) allows an income tax liability to be assessed upon and collected from "a transferee of property" of the taxpayer. This section only creates, however, a procedure for the collection of taxes from someone who, by reason of receiving a taxpayer's property, becomes, under pertinent state law, generally liable for the taxpayer's debts. *Commissioner* v. *Stern*, 357 U.S. 39, 42.

Arizona law applies here. Under the rule in force in Arizona, stockholders who receive corporate assets are required to respond to corporate creditors up to the full value of the assets received only if the corporation on liquidation is left without sufficient property to pay its creditors. *Love* v. *Bracamonte*, 29 Ariz. 227, 240 Pac. 351, modified in a respect not here material, 29 Ariz. 357, 241 Pac. 514; *Drew* v. *United States, supra; Coca-Cola Bottling Co. of Tucson* v. *Commissioner*, 37 T.C. 1006, affirmed, 334 F. 2d 875 (C.A. 9). The lower court properly applied this State rule (Pet. 7a) when it found that Martin was not liable as a transferee of Crystal's assets, because after the transfer of his shares in Crystal, he became merely a creditor of Tucson, and neither acquired a proprietary interest in any of the assets of Crystal upon its liquidation nor acquired an interest in Tucson under the pledge arrangement.

2. There is no conflict with the decisions on which petitioner relies (Pet. 3–4): *Drew* v. *United States*, 367 F. 2d 828 (Ct. Cl.) (which applied the identical Arizona law); *Bos Lines, Inc.* v. *Commissioner*, 354 F. 2d 830, 835 (C.A. 8); and *Bates Motor Trans. Lines* v. *Commissioner*, 200 F. 2d 20 (C.A. 7), all imposed

transferee liability on a stockholder of a liquidated corporation, who, unlike Martin, had received the corporate assets.

Beerman v. *United States* (C.A. 6), decided February 9, 1968 (68-1 U.S.T.C., par. 9209), and *Petschek* v. *United States*, 335 F. 2d 734 (C.A. 2), did not involve expenses incurred in contesting a tax liability. They arose not under Section 212(3) but under Section 212(2). That part of the statute allows the deduction of expenses paid for the "management, conservation, or maintenance of property held for the production of income", and has no application here.

Commissioner v. *Doering*, 335 F. 2d 738 (C.A. 2), is equally irrelevant. It involved the question whether expenditures incurred in suing to collect the proceeds of a claim to income that a corporation in liquidation had assigned to the taxpayer, one of its shareholders, were "expenses paid * * * for the production or collection of income" within the meaning of Section 212(1).

And although *Bonnyman* v. *United States*, 156 F. Supp. 625 (E. D. Tenn), affirmed per curiam, 261 F. 2d 835 (C.A. 6), allows the deduction of legal fees incurred to contest imposition of the gift tax, the decision was based upon Section 1009 of the Internal Revenue Code of 1939, which made the taxpayer, as donee, liable for payment of the gift tax.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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